DOCUMENT RESUME

ED 192 127 CE 026 724

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TITLE An Employment Policy to Fight Recession and Inflation: A Policy Statement by The National Council on Employment Policy.
INSTITUTION National Council on Employment Policy (DOL), Washington, D.C.
PUB DATE 8 Sep 80
NOTE 51p.: Not available in paper copy due to small, thin type.

EDRS PRICE MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS Career Education; Economic Climate; *Employment; *Inflation (Economics); *Policy; Public Service Occupations; *Unemployment
IDENTIFIERS *Recession

ABSTRACT

This publication contains An Employment Policy to Fight Recession and Inflation--the policy statement of the National Council on Employment Policy--and three background papers by individual members. The statement addresses these topics: Will the Recession End Inflation?, Which Anti-Recession Measures?, But What About Inflation?, and A Policy of Restrained Recovery. The first background paper is The Need for a Contingent Countercyclical PSE (Public Service Employment) Program. It contains a brief policy review, discusses the rationale for and merits of PSE, and lists steps that need to be taken. Employment Policy for Recessions, the second paper, addresses questions that are being neglected. It looks at the critiques employment policy in the 1973-75 recession and reaches some policy conclusions. The third paper, Getting at Fundamentals in the FY (Fiscal Year) 81 Budget, reexamines basic forces underlying the current economic situation. It considers the basic causes--inflation and unemployment--and proposes a solution involving reduced dependence on foreign energy sources, restrained total expenditures, increased productivity and production, and equitable sharing of the inevitably reduced standard of living. (YLB)

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AN EMPLOYMENT POLICY TO FIGHT RECESSION AND INFLATION

A Policy Statement by

The National Council on Employment Policy

Background Papers by

Vernon Briggs
Charles Killingsworth
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U S DEPARTMENT OF HEALTH, EDUCATION & WELFARE
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September 8, 1980

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The National Council on Employment Policy is a private nonprofit organization of academicians and policy experts with a special interest and expertise in the area of employment and training. The policy statement represents the combined judgment of the Council members. Despite divergence of opinion on details, the members agreed to a unanimous statement. The background papers have been prepared by individual members of the Council; the papers do not necessarily reflect the views of other Council members.

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AN EMPLOYMENT POLICY TO FIGHT RECESSION AND INFLATION

A Statement of the National Council on Employment Policy

The American economy is suffering through one of the worst inflationary periods in its history coupled with an extended bout of high unemployment. The country needs policies to simultaneously contain inflation, limit the extent and duration of the recession, and to cushion the impact of both upon the disadvantaged and unemployed. Mistakenly, much of the current public debate views growing unemployment as the only solution to inflation. Recognizing the seriousness of both problems, we pose two questions about the relationship between inflation and the current recession: First, what contribution will a more severe recession make in reducing inflationary pressures? Second, by how much will traditional countercyclical employment and training measures aggravate inflation? Our answer to both questions is: "Very little." We believe that policies are feasible--and that policymakers should pursue them--for minimizing the burdens of the recession and speeding recovery of the economy without contributing to a resurgence of inflation.

Will the Recession End Inflation?

The basic causes of the current inflation are overdependence on increasingly expensive foreign oil, an excessive growth of monetary aggregates (in part to pay for the oil), slower productivity growth, and excessive spending by consumers (in part as anticipation of future reduced purchasing power of their money). Recession in the short run reduces our demand for foreign oil, but will not wean us away from it when the economy starts to recover. Productivity ordinarily falls in the earlier phases of a recession, as plants are operated at less than optimum levels, but it tends to rise again during the early stages of recovery as production schedules expand. Beyond the impact of the business cycle on productivity, the secular growth rate of output per workhour has fallen in recent years. This means that the potential output of our economy is not growing as fast as in the recent past. Meanwhile, monetary stock growth rates have been highly erratic. At times they are large, in part, to finance our foreign oil bill; but then the authorities have pulled in the monetary leash resulting in high interest rates, reduced investment, and recession.

Consumers have maintained consumption levels in the face of falling real incomes by reducing savings and relying upon credit. Investments resulting in productivity growth and increased availability of goods and services were not inflationary, but expenditures for nonproducing equipment and highly speculative inflationary hedges were. Government spending becomes inflationary only when expenditures exceed tax revenues while the economy is running at close to full capacity. Any deficit in

times of high production contributes to a flow of expenditures increasing more rapidly than the flow of output of goods and services--the classic definition of "demand pull" inflation. But, though the recession will increase, not decrease the deficit, even a projected federal deficit of over $40 billion for fiscal 1981 is a minor influence in a $2.5 trillion economy. Rather, the causes of the current inflation have been on the supply side--leading to "cost push" inflation--as workers and firms raise the prices of their goods and services at rates higher than increases in productivity. Inflationary expectations built into the system, are reversed only to the extent people believe that prices will stabilize or fall for an extended period. But how real and lasting can such expectations be when so little is being done to attack inflation's basic causes?

We conclude that the recession, at high cost in economic output and human deprivation, will have only a modest temporary impact and little influence in constraining inflation in the long run. The near tripling of oil prices was a prime factor contributing to the pace of accelerated inflation during 1979. With no further oil price increases of that magnitude, the inflation rate would have fallen back to its underlying course without a recession.

Will Anti-Recession Measures Accelerate Inflation?

In the spring of 1980 balancing the federal budget was as much the conventional wisdom as was cutting taxes during the summer of the same year. The late Arthur Okun described the first as a placebo and the second is no less so. Tax revenues drop due to reduced recession incomes, and high unemployment causes expenditures to rise for entitlement programs such as unemployment insurance, public assistance and food stamps. This will happen even without any deliberate anti-recession policies; there is no realistic hope of a balanced federal budget as long as the rest of the economy remains unbalanced. Anti-recession measures contribute to inflation, not because they are excessive but because they are too late. The great advantage of the so-called automatic stabilizers is that they come into play as soon as employment and income begin to slacken and even before the advent of a recession is certain. Too often, recovery has begun before consensus can be reached on what other appropriate remedies and programs can be mounted and implemented.

But even the potential inflationary contribution of a deficit is no argument against measures to defend and redress the recession's victims, especially when the recession has been deliberately generated as an anti-inflationary policy. Elementary justice demands that those who do not suffer, and even may profit from the downturn, share the burdens of those who pay its price. It is the belated deficit spending, not the anti-recession measures, which may prove to be modestly inflationary. Financing the latter measures through increased taxes upon the beneficiaries is non-inflationary elementary justice.

Which Anti-Recession Measures?

Unemployment insurance is the traditional first line, and public service employment is increasingly the second line, of defense against the income and employment losses caused by a recession. Both have their strengths and weaknesses and are in need of basic reforms, yet they are needed in the current recession.

The Role of Unemployment Insurance

In 1975, at the depth of the 1974-75 recession, the price tag of the unemployment insurance system was $18 billion. Although the system cushioned the impact of high unemployment, it suffered from the experience. Trust funds were depleted, benefits were extended and coverage expanded. Yet, while job creation programs were being expanded under CETA, there was no serious thought given to coordination between the jobless benefits programs and the CETA programs. Regrettably, this may be happening again in the current recession.

Unemployment insurance is a useful means for supporting job search by the unemployed and for temporarily helping those likely to be recalled. However, UI also may subsidize periods of inactivity and non-production for individuals without job skills or reasonable job prospects. Excessive extensions of the duration of unemployment insurance benefits may simply drag out the periods of unemployment and nonproductivity of those unemployed who are most acutely in need of training, while draining the UI trust funds. Under these circumstances, we believe that there are more productive uses of public funds than the excessive federal extensions of UI which occurred in the last recession. Unemployment insurance benefits last a maximum of 26 weeks in most states with an automatic federal extension to 39 weeks triggered by high and persistent unemployment. In the 1974-75 recession duration was extended excessively to a maximum of 65 weeks. As an alternative to UI extensions, we believe subsidized employment or training should be offered to exhaustees.

We further believe that the employment prospects of UI recipients should be analyzed at the end of 26 weeks of unemployment. Those with imminent recall prospects might continue in an income maintenance status. For the others, funds should be used to expand employment and training opportunities. CETA prime sponsors should be allocated sufficient monies to provide training or public service employment to UI exhaustees seeking employment.

1. Individuals who have marginal skills should be placed in skill training programs. Training during periods of recession offers low social cost opportunities to increase the nation's productivity. We believe that increasing the skills of the unemployed will ultimately make these persons more employable. Also, it will increase the level of earnings they can command in the

future while at the same time making our labor force more competitive with foreign workers. Training opportunities also should be available to those persons with limited skills and job prospects who may wish to avail themselves of training rather than wait until their unemployment insurance eligibility has been exhausted. (This should be a voluntary decision, however, and not constitute a "work test.")

2. Persons who have no immediate job prospects and who have skills usable after the recession ends (e.g., construction workers), should be offered the alternative of countercyclical public service employment or jobs in public works programs. Such employment will have the distinct advantage of yielding a product to society which is not the case if these unemployed persons merely get UI extensions.

The basic philosophy behind these proposals is simple. We believe that society can gain more from the productive use of its human resources (through increased skill levels or production of useful output) than from long periods of payment for involuntary idleness. Budgetary costs would rise because of the costs of administering employment and training programs and the likely premium of wages over income maintenance benefit levels. But these would be more than offset by the economic gains of added output, future productivity, and the prevention of the debilitating consequences caused by forced idleness.

However, these proposals, along with other longer-term reforms, though badly needed, may take time to be fashioned and implemented. In the shorter run, the basic weaknesses of the unemployment insurance system, which has not recovered from the strains of the last recession, must be recognized. It is no longer in shape to serve exclusively as the first line of anti-recession defense. It needs early and greater collateral support from the public service employment program.

The Job Creation Alternative

During the early and mid-1970s, public service employment (PSE) was revived as an instrument of fiscal policy. It was designed essentially as a countercyclical weapon and used in a conscientious way to reduce the aggregate level of unemployment. But, as the unemployment rates declined from the 8 percent range to the 6 percent range, the enabling legislation was altered. With the 1978 CETA amendments, public service employment was converted into a job creation program targeted to serve the economically disadvantaged and the long-term unemployed--a necessary long-run priority. However, because of these legislative changes, public service employment is no longer as well suited to fill its countercyclical role.

The Council believes, therefore, that the following actions are necessary:

1. The CETA component designed to provide public service jobs for economically disadvantaged and structurally unemployed should be retained with substantially increased funding. With the increase in aggregate unemployment, the clients of this program are now in an even worse competitive situation for jobs, given increasing numbers of persons available who are better qualified to fill regular job openings.

2. CETA already authorizes a countercyclical public service employment program. A funding trigger mechanism was built into the legislation to make funds available to employ 20 percent of the number of persons in excess of 4 percent unemployment and 25 percent of the excess above 4 percent when the unemployment rate is over 7 percent. However, Congress has not appropriated the funds the legislation promises. The necessary funds should be made available without delay.

3. The 1978 CETA reauthorization, as noted, restricted eligibility for countercyclical jobs largely to the structurally unemployed and members of low income households. To restore the original countercyclical role, the following changes should be adopted:

   a. Eligibility criteria should consider the length of unemployment and not only family income; persons who have been unemployed for 15 out of the past 26 weeks should be eligible automatically.

   b. A wage ceiling should be set for the maximum federal contribution, but the federal ban on local government supplementation should be replaced by a local or state option to increase wages on some proportion of the jobs created.

In addition to providing jobs to unemployed persons, these changes will greatly reduce the current administrative burdens of checking and monitoring family incomes in order to verify eligibility, and will allow a higher quality of work to be accomplished.

During the 1970s, the effectiveness of countercyclical job creation programs was impeded because they were introduced late in the recession. Consequently, the rules and regulations were drafted hastily and there was inadequate time for appropriate planning or staffing. The rapid expansion of counteryclical public service employment in 1977-78, after recovery was well underway, greatly overtaxed the administrative capacity of the CETA system, leading to well-publicized errors and inefficiencies during implementation. As a result, the application of PSE as a countercyclical tool was criticized for the wrong reasons. If countercyclical public service employment programs were in place before they were needed, the expansion of public service employment as unemployment rises could be implemented in time to stimulate the economy and to provide much needed jobs.

For the future, the Council believes that specific provisions for implementation of a stand-by countercyclical public service employment program with a general labor force focus should be added to CETA. The primary intent should be to have a countercyclical program triggered and funded once the need arises.

The Private Sector Alternative

While considering needed changes in CETA public service employment provisions, the relatively untried program to promote private sector initiatives should not be ignored. Most employers have a difficult time participating in programs for the disadvantaged and the unemployed when their own permanent employees are on layoff. But all employers are not impacted upon equally by recession. The CETA private industry councils should be encouraged to experiment with what can be accomplished by subsidized employment in a time of high unemployment. Private employment has generally more potential than public employment for long-term solutions of the working life problems of the disadvantaged.

But What About Inflation?

Paradoxically, higher energy prices are a necessary component to any long term solution to persistent inflation in the US economy. Boosts in oil prices cannot do a great deal to increase domestic oil production because readily accessible domestic reserves have been consumed. But alternative energy sources become viable when oil prices at least equal the production costs of those alternatives. These higher energy costs are the price that must be paid to end excessive dependence on foreign oil. The time for those higher costs to be imposed is early in a recession when other price pressure may be somewhat dormant and not later when both energy demand and other pressures are rising.

Tax cuts may be necessary to offset the effect of payroll tax increases and the rising taxes triggered by inflation which may inadvertently thwart a budding recovery. If tax cuts are introduced, they should be directed to help those most adversely affected by inflation and unemployment. Cuts designed to increase consumption may speed recovery but they will almost certainly contribute to a later resurgence of inflation. Total purchasing power can be maintained by tax cuts designed to increase investment and productivity. In general, this resulting investment will create higher quality jobs than those created by consumption expenditures. However, it is difficult to get the private sector to make these needed investments when idle capacity already exists.

A Policy of Restrained Recovery

This brief statement presents only two necessary elements of a comprehensive policy. The pre-1973 recessions usually justified a single-

minded policy: "Get America moving again!" Recovery policies in 1975 should not have been that limited, and in 1980 must not be so simplistic. There are two justifiable objectives: (1) Ease the burdens of those paying the price of intended anti-inflation gains for the rest of us, and (2) Get the country onto a non-inflationary growth track. We know far more about how to do the first than the second. Yet while the second goal may be difficult it is not impossible.

Our economy needs careful, deliberate but aggressive applications of income maintenance, training, and job creation policies. It requires also extreme care in tax reduction policies, focusing on the cuts justified on the basis of improved investment in productivity. It also calls for "biting the bullet" in solving our foreign energy dependence, restraining monetary growth, and removing other structural contributors to inflation. Solutions to the inflation problem are integrally tied to these long-run problems, including reduced dependence upon foreign energy sources, increased modernization through capital investment and technological change, improved productivity, expanded foreign markets for US-made goods, and increased competition in domestic US markets. Policies for achieving these ends are likely to be filled with risk and uncertainty; but they hold potential for stabilizing the American economy and strengthening the foundation for renewed growth and expansion.

THE NEED FOR A CONTINGENT COUNTERCYCLICAL PSE PROGRAM

Vernon M. Briggs, Jr.
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One of the most significant developments in the field of employment and training policy to occur in the past decade was the revival of job creation programs. Virtually dormant as a policy instrument since the 1930s, public service employment (PSE) became a contender in the 1970s for prominence in the nation's arsenal of policy weapons to combat unemployment. The evolution of PSE during this era has been laced with controversy and criticism. Within the span of a mere ten years, PSE has not only had to compete with more traditional policy measures for support; it has also been forced into sharply divergent roles as the result of frequent legislative changes in its programmatic content and objectives.

With the substantial increases in unemployment rates as the 1980s begin, PSE in its present form has been stripped of any real potential as a countercyclical policy instrument. Its usefulness as an effective means of combating general unemployment has been nullified by the Comprehensive Employment and Training Act (CETA) Amendments of 1978. Without abandoning the economically disadvantaged from a chance to have access to PSE positions, it is essential that PSE also be made available to the general labor force as well. For unless changes are made in the existing legislation or a new title is added, it will be impossible for any administration in the 1980s to utilize PSE as an effective instrument of fiscal policy.

A Brief Policy Review

During the late 1960s, the need for some form of job creation program was noted by several congressional committees. PSE was also specifically advocated by a number of presidential advisory commissions during that era. But it was not until 1971 that a specific PSE program was enacted. Then, with unemployment rates on the rise (in the high 5 percent to low 6 percent range), Congress initiated and President Nixon signed the Emergency Employment Act (EEA) of 1971. EEA was the first straightforward job creation law to be enacted in the United States since 1935. EEA was enacted as a pure form of countercyclical PSE. The jobs created were to be "transitional" in nature. It had a general population focus but with a strong preference given to veterans.

Subsequently, the EEA program as well as most of the other existing manpower programs were merged into the Comprehensive Employment and Training Act (CETA) of 1973 (which became effective on July 1, 1974). CETA created a nationwide system of prime sponsors to administer most of the programs authorized by its provisions. Under the original CETA of 1973, PSE was authorized under two titles.

Under Title I, a local prime sponsor was free to choose from a variety of different human resource services in order to achieve a combination of programs that seemed most appropriate for the citizens of its area. Among the fundable array of programs was public service employment. Under Title II, funds were available solely for PSE purposes but restricted to areas where the unemployment rate was 6.5 percent or more for three or more consecutive months. Thus, Title II PSE was essentially countercyclical in its intention and it had a general population focus.

Hardly had CETA begun before it was amended in late 1974 by the Emergency Jobs and Unemployment Assistance Act. Passed in response to further increases in the national unemployment rate (averaging more than 6 percent), the Act added a new Title VI to CETA. This original Title VI was designed exclusively as a countercyclical weapon. It was intended to encourage prime sponsors to hire unemployed persons as quickly as possible and to employ them in public service jobs. Title VI funding differed substantially from the Title II funding formula. Under the original Title VI, 50 percent of the distributed funds were based on the proportion of the nation's unemployed population in an area's jurisdiction; 25 percent of the proportion of the area's share of all unemployed persons in excess of 4.5 percent of the labor force; and 25 percent among those areas of substantial unemployment (i.e., 6.5 percent unemployment for three consecutive months). Local areas with unemployment in excess of 7 percent were able to hire people who had been unemployed for only 15 days.

The thrust of the public service employment programs authorized under Titles II and VI, therefore, was toward geographical areas with high unemployment rates as officially measured (i.e., those areas with a high proportion of unemployed workers covered by unemployment compensation). Emphasis was given to participation by persons who had both low income and who had suffered long term unemployment.

In October 1976, the temporary countercyclical program enacted in 1974 as Title VI was renewed by the Emergency Jobs Program Extension Act of 1976. It provided for the extension of Title VI and it also called for a major redesign in program format. To overcome criticisms that the original Title VI program was simply allowing local governments to substitute federal funds for local funds in hiring public workers, the new Title VI required program sponsors to establish clearly definable "projects." Each "project" had a fixed completion date of no more than one year. Moreover, the "projects" were supposed to be in employment ventures that local governments would not normally be able to fund. The Act also required that 50 percent of all new hires that year be filled by low income, long term unemployed persons.

As unemployment remained high in 1976, the Carter administration pressed for an expansion of the existing PSE programs shortly after it came into office in 1977. The administration was successful in its efforts. The Economic Stimulus Appropriations Act of 1977 was enacted. Almost half of the $20 billion stimulus was earmarked for expansion of the existing public service employment programs during 1977 and 1978. During this time period, the level of PSE participation increased from about 300,000 to 725,000 persons and the nation's unemployment rate declined from over 7 percent to less than 6 percent over the interval.

In 1978, the original lifespan of CETA expired. Thus, Congress was given the opportunity to terminate, rewrite, or reauthorize all CETA activities. Ultimately, CETA was reenacted in October 1978, but with a number of fundamental changes. The public service employment eligibility provisions were changed dramatically. The new Title II(D) program has become entirely a structural PSE program. Eligibility is restricted to persons who are receiving welfare or are economically disadvantaged and who have been unemployed for 15 weeks or more. All PSE positions under Title II(D) must be at the entry level and, where possible, are to be combined with training and supportive services. For the first time with respect to all previous PSE endeavors of the decade, no local salary supplementation is permitted.

Title VI was retained nominally as a form of countercyclical PSE. But it is actually a highly targeted PSE program to help only certain groups of people in areas of high unemployment at any time. A trigger mechanism was built into the legislation. Funds are supposedly to be made available to employ 20 percent of the number of persons in excess of 4 percent unemployment and 25 percent of the excess above 4 percent when the national unemployment rate is in excess of 7 percent. At least 50 percent of the funds are to be used to employ persons in "projects" of up to one year duration. All persons not employed in "projects" but who are in regular PSE positions can only be employed at entry-level jobs. Title VI, although billed as countercyclical, requires that all participants be unemployed for ten out of twelve weeks prior to application and come from a family whose income is below the Lower Living Standard Income (LLSI) level or is receiving welfare. For a person who becomes unemployed but who is from a family that did not previously qualify on the basis of its income level, he or she is eligible for PSE only if the family's total income on an annualized basis remains less than the LLSI for the three consecutive months prior to enrollment. Also with respect to both Titles II(D) and VI, no person may be employed in any form of PSE job for more than 18 months. Severe restrictions, therefore, are currently placed on the types of people and the types of jobs for which PSE funds can be used.

The Rationale for PSE

The factors that explain the drastic conceptual changes in PSE that occurred with the 1978 CETA Amendments are complex and somewhat controversial. The rapid build-up of PSE in 1977-78 greatly overtaxed the administrative capabilities of the young system. It should be recalled that the CETA delivery system was less than three years old when the PSE build-up occurred. As a form of institution building, it takes time before local expertise is developed to handle the responsibilities of implementation of national economic policies. But in this case, no lead time for adequate planning or staffing was provided. Extreme pressure was exerted on prime sponsors to meet their hiring goals as quickly as possible. Threats were made that if these goals were not met rapidly, the money would be taken away and assigned to other prime sponsors who could meet such performance requirements. At the same time, the prime sponsors were in the process of implementing an entirely new and comprehensive youth employment initiative (i.e., the varied programs created under the Youth Employment and Demonstration Projects Act of 1977). Furthermore, as indicated ear-

lier, the PSE programs themselves went through a number of modifications in both content and program design during the period immediately preceding the build-up. Thus, the prime sponsors did not have sufficient experience with the existing PSE programs to prepare themselves for the strains and pressures of the rapid expansion. The result could have been predicted. A number of highly publicized incidents of mismanagement and inefficiency occurred in the implementaton of the expanded PSE programs. When the reauthorization of 1978 occurred, Congress reacted in a negative way to the entire concept of a countercyclical PSE program. The strengths of PSE over the alternative forms of fiscal policy seemed to be forgotten in the congressional haste to chastise the CETA delivery system.

The Merits of PSE

It is of little value to discuss any policy proposal in the abstract. Rather, the merits and demerits of PSE as an instrument of fiscal policy must be assessed in relation to other means of reducing unemployment. To be specific, the primary policy alternative to PSE is tax cutting. The policy research that paralleled the evolution of PSE programs during the 1970s has convincingly demonstrated the relative advantages of PSE over tax cutting as a means of accomplishing their common objective. Among these considerations are that PSE can achieve a specified level of aggregate demand more quickly than a tax cut since the latter must wait for consumers to spend their tax savings before there is any effect; the direct creation of jobs is quicker under PSE than by tax cuts since the PSE jobs are created at once whereas tax cuts do not initially create new jobs and will do so only after tax savings are spent and existing inventories are depleted; PSE jobs can be targeted directly to those people and regions who need additional jobs whereas tax cuts can trigger inflationary pressures when consumers spend tax savings on items that are in short supply or create a demand for jobs for which the unemployed cannot qualify.

The major functional criticism of PSE as an effective job stimulation device has centered upon charges of job substitution. It was alleged that local governments merely substituted the PSE funds for their own funds that would otherwise be used to hire the same people. If true, this could nullify the effectiveness of PSE as a plausible countercyclical device. But, this criticism overlooked the fact that even if employment substitution did occur, the availability of PSE would enable local and state governments to release those funds to spend on other goods and services which would also stimulate an increase in aggregate spending. Also, the availability of PSE workers could preclude or lessen the severity of any counterproductive tax increases that might be necessary at the local level to maintain a needed level of public services. It is also conceivable that the availability of PSE workers could allow some local taxes to be reduced with no loss in public services. The requirement that a substantial number of PSE workers be assigned to short term projects that are definable and distinct from other activities sponsored or provided for by local and state governments was an additional protection against possible substitution.

Thus, despite the clear superiority of PSE over tax cuts as an effective means of combating mounting unemployment, the CETA Amendments of

1978 that have restricted both the types of people who are eligible and the types of jobs they can hold have made it virtually impossible for PSE to serve as a policy tool for combating a general increase in the level of aggregate unemployment. As a result, by default, tax cutting is now the only readily available means to accomplish this end. Tax cuts are always politically popular even though they are a clearly second-best policy as a means of reducing unemployment in a less inflationary manner.

As an immediate response to rising unemployment, an available PSE program is superior to sole reliance upon subsidized unemployment through unemployment compensation. PSE at least offers the assurance of increased production for its claim upon public expenditures.

The Steps that Need to be Taken

The nation needs to have a contingency plan that involves a significant PSE program to be used as a countercyclical measure for the benefit of the general labor force. At present, the PSE programs that exist are essentially structural in their orientation. The case for a contingency countercyclical program does not in any way diminish the need for the existing structural PSE programs. Rather, it simply means that there are benefits of having a separate countercyclical program available as a standby option if it should be needed. If the legislation were enacted for such a proposal, the planning could begin and the administrative shortcomings of past crash build-ups in PSE could be largely avoided. All of the rules, regulations, guidelines would be known. All funding formulas would be in place. For virtually the first time in the history of any employment and training program, sufficient understanding and planning for such a program could all be done in advance. Then, if and only if the need should arise, all that would be necessary would be for the funding appropriation to occur.

There are two possible ways to implement the proposed program for a contingent countercyclical PSE program. One is to revise the current restrictions and practices that prevent Title VI from becoming a truly countercyclical PSE program. The second alternative is to add immediately a new title to CETA that would authorize such a PSE program to meet the employment needs of the general labor force during times of high national rates of unemployment.

If the first route is taken, several changes would be required. First, Congress would have to fulfill the funding pledges that are already called for under the existing Title VI of CETA. The trigger requirement that calls for funds to increase as unemployment rises is already in place. But the appropriations that are required to meet these authorized increases in program operations have not been forthcoming. In fact, existing budget plans call for an arbitrary reduction in the scale of PSE operations. A trigger mechanism for a policy weapon that is actually unloaded eliminates the effectiveness of the entire concept. The trigger concept of Title VI must include an automatic funding process if it is to be meaningful. In addition, the existing legislative limitations on the eligibility of who can participate; the types of jobs that participants can hold; the wage rates that participants can receive; and the opportunities for local govern-

ment to supplement wages and salaries should be waived automatically when the national unemployment rate reaches a specified level (e.g., 6.5 percent) for a specified time period (say 3 consecutive months). In this way, Title VI could serve the general labor force and Title II(D) PSE could remain reserved for the economically disadvantaged who are also unemployed.

The second alternative would be to add a new title to CETA. It would authorize a standby countercyclical PSE program that would be similar to that enacted under the Emergency Jobs and Unemployment Assistance Act of 1974. It would be a simple program that would encourage prime sponsors to employ persons in useful private sector jobs as quickly as possible. It would be authorized to become operative should the national unemployment rate exceed a specified level (say 6.5 percent) for a specified number of months (say 3 consecutive months). The President then could request immediate funding for the creation of a sufficient number of jobs to return the unemployment rate to the 6.5 percent level. Funding should be sufficient to allow those hired in the program to remain in subsidized employment for a set period of time (say 18 months) regardless of whether the aggregate rate should subsequently fall back to or below the 6.5 percent level. As under the Act of 1974, eligibility for participation should vary with the local unemployment rates. For example, any person unemployed for over 30 days would be immediately eligible but in those local areas with higher unemployment rates, the period of unemployment could be less.

The new program should specify that local and state governments maintain their previous levels of employment. But given the lead time to do effective planning for the specific occupations in which PSE participants would be employed, it should be possible to avoid many of the administrative pitfalls that occurred during the 1977-78 build-up. Also, it should be possible for local and state governments to prepare well in advance a list of needed public services and projects that could be implemented during such periods of economic recession. Although a federal wage ceiling would have to be set, local governments should have discretion to supplement those ceilings if they see fit.

Under either of the proposed alternatives, the lessons of the past should be incorporated into the appropriate rules and regulations. Namely, as a countercyclical program, it should be clearly understood that participants should <u>not</u> be hired and employed in occupations that provide essential government services (i.e., policy, fire fighters, and sanitation services). Rather, the jobs that are created should be in activities that make communities better places to live and to work but are not absolutely essential to its ability to operate in a viable manner (e.g., conservation, beautification, the arts, weatherization, housing rehabilitations, care for senior citizens, child care, or educational enrichment).

Conclusion

The nation needs to have an available alternative to tax cuts as a means of creating jobs should the economy require immediate stimulation. PSE has proven its usefulness as both a countercyclical and a counter-structural policy weapon. As matters now stand, there is no truly countercyclical PSE program available for immediate implementation. It is suggested that there should be.

EMPLOYMENT POLICY FOR RECESSIONS

Charles C. Killingsworth

For the third time in a little more than ten years, the U.S. economy is sliding into a recession. Virtually every indicator of economic activity confirms that what was for a time hopefully labelled a "slowdown" has become another major recession. Some voices are still heard predicting that the recession will be "short and mild," but they are fainter and fewer. In late spring, the rapidity of the downward slide appeared to equal or even to exceed the momentum of late 1973 and early 1974, which was the beginning of the most severe recession since the 1930s. At this writing, it is still too early to predict with confidence the severity of the new recession. But it already seems clear that there is a reasonably strong possibility that this recession will be as severe as the last one, and there is no compelling reason for ruling out the possibility that it will be more severe.

Students of the business cycle point out that every recession has its own patterns. Excessive inventories held by businesses are usually blamed for the severity of the 1973-75 recession, and some analysts now find encouraging the fact that inventories do not seem to be as excessive at present. On the other hand, the current recession was obviously deferred for many months by an abnormally high level of consumer spending, partly financed by credit expansion. Now consumer confidence, as measured by the standard surveys, has reached historic lows, and sales of houses, cars, appliances and other durables are falling at a remarkably rapid rate. The effects of the sharp curtailment of consumer spending are beginning to radiate through the economy. The national unemployment rate, which is classified as a "lagging" indicator of the state of the economy, has begun to rise sharply.

When the reports on the economy are bad, those in authority are always tempted to fall back on the classic plea, "Let's wait for next month's figures." Fifty years ago, Herbert Hoover immortalized the phrase, "Prosperity is just around the corner," as he presided over the nation's slide into the worst depression in our history. Today, the increasing velocity of the downward movement in the economy is surprising almost all informed observers. Nevertheless, top administration figures express confidence in the outlook and promise in general terms that ways will be found to help the poor if things get really bad; but the only specific proposals under discussion involve substantial reductions in the kinds of programs that are intended to help the poor. Congress is struggling to achieve a "balanced budget"--an exercise that has lost its relevance because the revenue and expenditure estimates which are to be "balanced" have been rendered obsolete by the rapid rise in unemployment. The rule of thumb for forecasters is that each one percent rise in the unemployment rate raises expenditures for unemployment compensation and welfare by $5 billion to $7 billion per year and reduces revenues by about $20 billion per year. If the current recession follows the pattern of the 1973-75 recession, income support expenditures will rise so much above administration estimates and revenues will fall so far short that balanced budgets will be far out of reach for several years even if no new programs for the

relief of unemployment are enacted. Policy discussion is lagging farther and farther behind the accelerating course of events.

Greater attention to the employment policy questions urgently posed by the rapidly-developing recession is overdue. These questions have been neglected in part because of a widespread conviction that higher unemployment is the harsh price that must be paid to get inflation under control. Another reason for the neglect of these questions is the generally modest estimates of the level of unemployment in 1980 and 1981. The administration forecast in January, 1980, was for an unemployment rate in the fourth quarter of this year at 7.5 percent, and in the fourth quarter of 1981, at 7.3 percent. These rates imply little more than a mild "slowdown" in economic activity. If we assume a recession of the same magnitude as the one in 1973-75 and comparable increases in the unemployment rate, we get much higher rates. Eighteen months after the 1973-75 recession began, the unemployment rate had risen by 4.2 percentage points, to a high of 9.0 percent. A comparable increase in the present recession, which began with an unemployment rate around 6 percent, would result in a peak unemployment rate above 10 percent, probably in 1981. In other words, if the administration forecast of a "short and mild" recession is as badly mistaken as current developments indicate, its estimate of the magnitude of the emerging unemployment problem is about 2.5 to 3.0 million persons too low.

A good starting point for the discussion that is overdue is a critical examination of the principal policy approaches to the unemployment and income loss problems caused by the recession of 1973-75. Such an examination supports the conclusion that in recent years we have developed and tested an impressive array of employment policy instruments, and that our present need is much less for entirely new instruments than it is for guidelines to the best and most balanced use of the existing employment policy instruments to meet the burdens of unemployment and income loss.

Analysis of the experience during the 1973-75 recession also leads clearly to the conclusion that excessive reliance was placed on one of the oldest policy instruments, the unemployment insurance system; that this overload significantly weakened the financial reserves of the system; and that throwing a comparable overload on this system in a new recession threatens to create some serious problems, both short-run and long-run, and may compel drastic revision of the unemployment insurance system itself. This system is a valuable national asset which has performed its intended function well. Overall employment policy should be balanced in such a way that the unemployment insurance system is protected from the serious damage that overloading it would cause.

Concern about rising unemployment often evokes the response that if things get really bad, a tax cut may be justified. There has been almost no attention to the question whether tax cuts are the most cost-efficient approach to the reduction of unemployment. When that question is examined, it quickly becomes clear that tax cuts are the <u>least</u> cost-efficient way to reduce unemployment. Other policy instruments have much larger effects on unemployment, in the sense that much smaller government expenditures on these other policy instruments induce a larger expansion of employment than tax cuts. To the extent that excess demand has contributed to the recent high levels of inflation, the use of tax cuts as the primary

method of reducing unemployment would be certain to make inflation control more difficult. There may be other valid reasons for reducing some taxes; but there are more efficient and much less inflationary instruments for dealing with unemployment.

The Prologue

"What is past is prologue," wrote Shakespeare. The aphorism is especially applicable to any meaningful analysis of policy approaches to unemployment. The rush to explain the latest month's figures sometimes diverts attention from the gradual, cumulative changes that have helped to produce the latest figures. Prior to the most recent sharp rise in the unemployment rate, the monthly figures had fluctuated within the relatively narrow range of apprxoimately 5.7 to 6.0 percent for about 18 months. (See Chart 1). The relative steadiness of the rate at this level prompted some speculation that the "full employment unemployment rate" had now risen to almost 6 percent. Some analysts pointed to larger numbers of teenagers and women in the labor force as explanatory factors; but the weakness of that "explanation" was that it ignored some important offsetting factors, such as substantial declines in the labor force participation rates of black males and older, less-educated males. It also ignored the significant effects of changes in the definition of unemployment, which had lowered the reported rates.

Whatever the explanation may be, the unquestionable fact was that unemployment in 1978-79 was higher than it ever had been before during the prosperity phase of the business cycle. As Chart 1 shows, in the late 1960s the unemployment rate was below 4 percent. Following the 1970 recession, the rate remained high for two years; but in 1973, just before the next recession, the rate was down to 4.8 percent. The present recession took off from a base which was at least one full percentage point higher than it was at the beginning of the last recession. The 1968-79 period appears to show a kind of stair-step rise in the prosperity unemployment rate which is strikingly similar to the stair-step progression was equally apparent in the 1953-63 period. (See Chart 2). This development in the 1950s and early 1960s got much attention and discussion. The more recent development of a similar pattern in the 1970s has been generally ignored up to now.

One difference between the pre-Vietnam and post-Vietnam patterns should be pointed out. In the 1950s and early 1960s, each recession peak in the unemployment rate was followed by a fairly rapid decline in unemployment to the new prosperity level. In other words, the fall in unemployment (as far as it went) was about as rapid as the rise in unemployment had been during the recession. That pattern has not carried over into the 1970s. As Chart 1 makes quite clear, in the recovery and prosperity years following the last two recessions, the unemployment rate has declined very slowly from the recession peak. In the 1970s, the American economy was much more effective in generating higher levels of unemployment than in generating new jobs to reduce unemployment after the recession had reached its trough. If this new pattern of the 1970s carries over into the 1980s, we must face the prospect of weak labor markets, with unemployment rates possibly in the range of 8 to 10 percent, for the next four or five years,

CHART 1

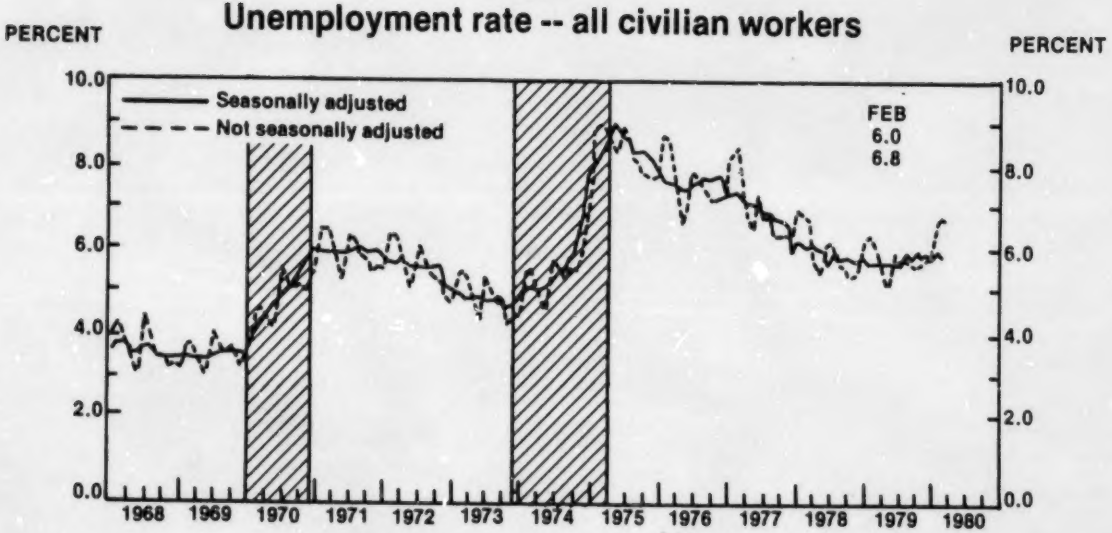
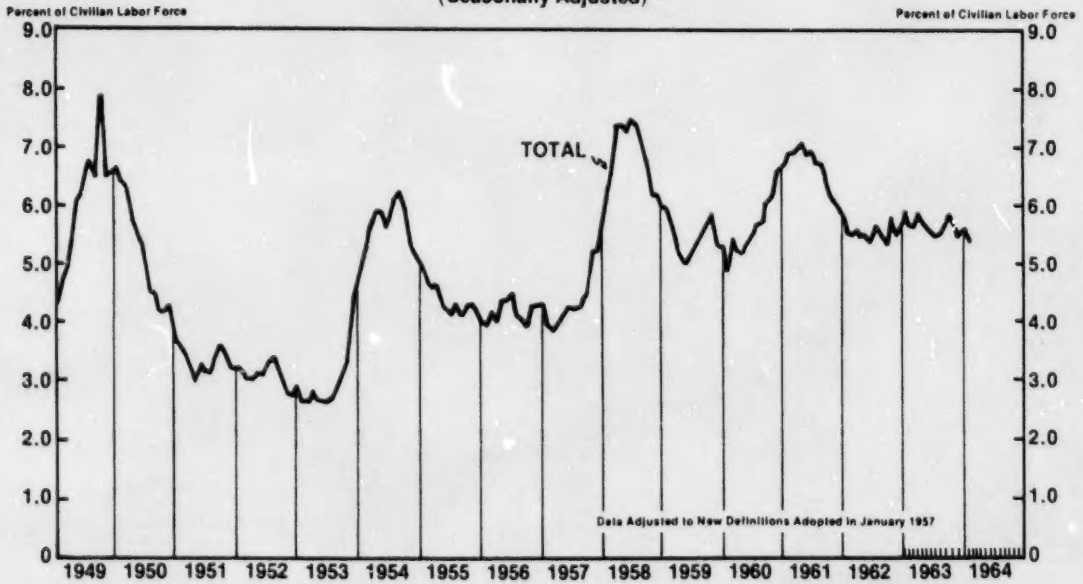

Unemployment rate -- all civilian workers
PERCENT
PERCENT
Seasonally adjusted
Not seasonally adjusted
FEB
6.0
6.8
10.0
8.0
6.0
4.0
2.0
0.0
1968
1969
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980

CHART 2

UNEMPLOYMENT RATE
January 1949 to January 1964
(Seasonally Adjusted)



depending on the duration and severity of the recession that has just begun.

The economic policies of the federal government in the months and years ahead could change that prospect, making it either better or worse, depending on the choices that are made. Hence, it seems urgently necessary to analyze our experience with the instruments of employment policy in recent years, and especially during the 1973-75 recession, to see what lessons we can learn about better ways to meet the emerging problems of a new recession.

Employment Policy in the 1973-75 Recession

This discussion defines "employment policy" to include (among other things) the measures used to replace the income lost from unemployment as well as the measures intended to revent unemployment, to increase employability and to create jobs. In dollar terms, during the 1973-75 recession the biggest program in this broadly-defined area was unemployment insurance. Total expenditures under this program rose from about $300 million per month in mid-1973 to a maximum of about $1.7 billion per month in early 1976. Table 1 and Chart 3 show the details. Expenditures rose from $7 billion in 1974 to nearly $18 billion in 1975 and fell only to $16 billion in 1976. To put the matter in perspective, we can say that expenditures rose from a total of $17 billion in the three years preceding the recession (1971-73) to $41 billion in the three recession years (1974-76), an increase of 140 percent. A full discussion of the intracacies of unemployment insurance financing is beyond the scope of this paper; but it should be pointed out--indeed, emphasized--that most of the money just mentioned came from the states, not the federal government.

Income maintenance expenditures (Aid to Families with Dependent Children, General Assistance, and Emergency Assistance) do not go entirely, or even mainly, to those who have lost their jobs because of a recession; but some of the unemployed do end up as income maintenance program beneficiaries. Table 2 shows that income maintenance expenditures did increase substantially during 1975 and 1976, although not by nearly as much as unemployment insurance either in dollar terms or in percentage terms. In the calendar years 1971-73 inclusive, income maintenance expenditures were $22.5 billion, and in 1974-76, they were $30.5 billion--an increase of 36 percent. As the table shows, income maintenance expenditures have shown a steady growth trend; and even in 1978, expenditures were half a billion dollars above 1977. Some of these increases are obviously caused by non-cyclical factors. But the two biggest jumps shown on this table cane during recession years. It should be noted that the income maintenance programs are financed by a combination of federal and state dollars, usually through annual or biennial appropriations.

Employment and training expenditures increased during 1975 and 1976 at a more rapid rate than income maintenance expenditures.* Using the

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*Some of the apparent increase simply made up for the substantial cut in employment and training expenditures which occurred in Fiscal Year 1974; there had been a reduction from $3.0 billion in FY 1973 to $2.4 billion in FY 1974, largely because of the phasing out of the emergency employment program. (See Tables 3A and 3B).

TABLE 1

UNEMPLOYMENT BENEFIT EXPENDITURES - ALL PROGRAMS 1970 to 1979
(In Millions of Dollars)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
January	317	619	634	527	638	1310	1733	1454	1121	1011[a]
February	328	649	651	454*	629	1401	1578	1438	1106	948[a]
March	352	730	723	483	669	1613	1734	1594	1185	1012[a]
April	341	640	555	398	631	1667	1487	1229	874	818[a]
May	312	524	511	37[illegible]	559	1588	1211	1028	794	756[a]
June	313	541	461	320	453	1509	1275	995	722	
July	339	494	439	332	534	1603	1285	906	696	
August	337	499	442	357	522	1480	1266	1020	824	
September	324	465	350	284	455	1302	1111	865	662	
October	329	436	348	320	519	1411	1008	820	659	
November	365	476	375	328	562	1291	1126	874	693	
December	496	586	409	375	825	1651	1319	960	788	
Q_1	997	1998	2008	1464	1936	4324	5045	4486	3412	2971[a]
Q_2	966	1705	1527	1092	1643	4764	3973	3252	3252	
Q_3	1000	1458	1231	97[illegible]	1511	4445	3662	2791	2791	
Q_4	1190	1498	1132	102[illegible]	1906	4353	3453	2654	2654	
Annual Total	4153	6659	5898	4552	6996	17,886	16,133	13,183	10,124	
% Change from Previous Year		+60.3%	-11.4%	-22.8%	+53.7%	+155.7%	-9.8%	-18.3%	-23.2%	

*Prior to February 1973 data include payments under State extended duration of benefits provisions. Not included after February 1973.

[a]1979 data do not include expenditures on Federal - State Extended Benefits, as such information is unavailable.

Data are a compilation of benefits from State UI, UCFE, UCX, Federal Supplemental Benefits, Federal-State Extended Benefits, and Special Unemployment Assistance programs. Preponderance of data from monthly volumes of Unemployment Insurance Statistics. Data not found in this publication are gathered from Monthly Labor Review, Unemployment Insurance Financial Data 1938-1976, and The Federal Supplemental Benefits Program: National Experience and the Impact of PL 95-19. Data for which monthly totals are not available have been estimated by prorating annual expenditures over each of the 12 months in the year.

Chart 3

Monthly Unemployment Benefit Expenditures - All Programs 1970 to 1978
(In Millions of Dollars)

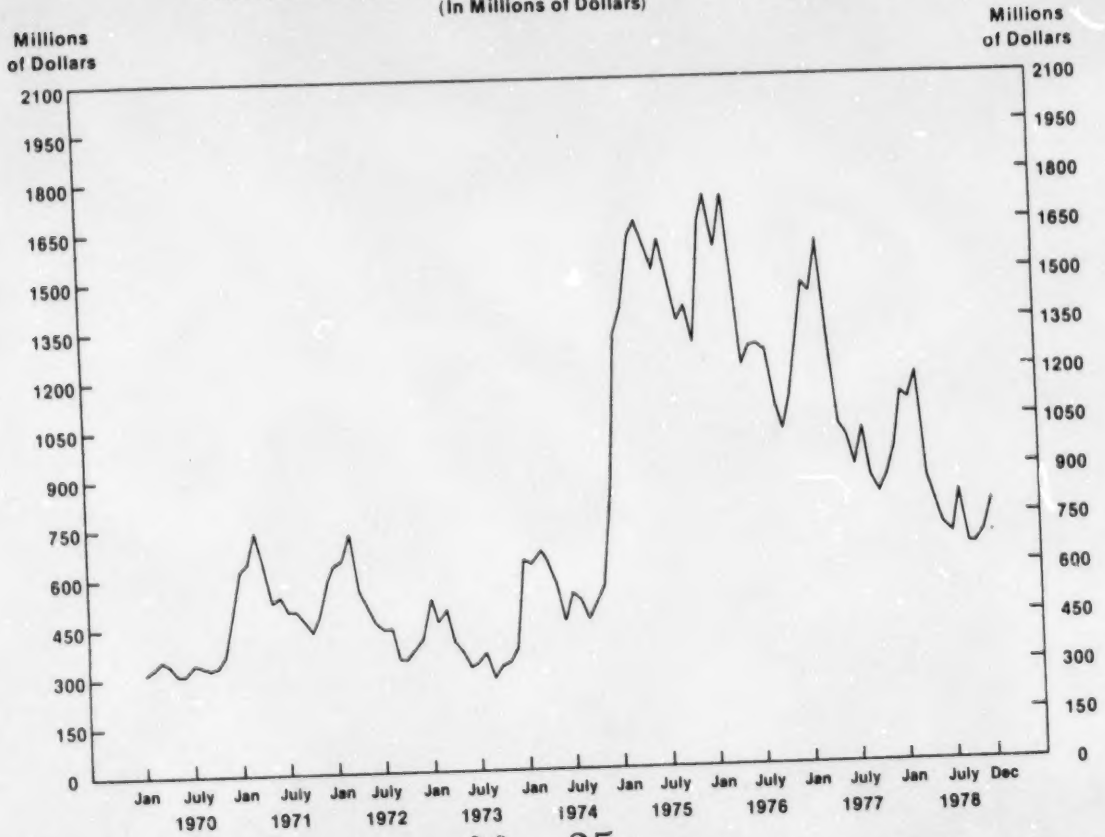

TABLE 2

INCOME MAINTENANCE EXPENDITURES 1970 to 1979
(Millions of Dollars)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
January	391	547	623	657	689	825	932	954	1006	1005
February	399	458	625	657	704	834	926	956	1008	999
March	413	579	658	669	716	853	998	975	1021	1009
April	421	570	636	659	703	846	938	962	1011	
May	430	567	628	648	704	844	929	951	993	
June	442	571	632	648	704	834	919	938	992	
July	454	579	638	645	726	860	944	959	997	
August	473	586	640	656	750	871	937	967	1001	
September	497	600	653	668	754	904	942	956	993	
October	503	595	647	677	769	922	936	967	1000	
November	511	606	655	674	777	911	938	953	996	
December	548	623	662	676	809	922	953	996	995	
Q_1	1203	1584	1906	1983	2109	2512	2856	2885	3035	3013
Q_2	1293	1708	1896	1955	2111	2524	2784	2851	2996	
Q_3	1424	1765	1931	1969	2230	2635	2823	2882	2991	
Q_4	1562	1824	1964	2027	2355	2755	2827	2916	2991	
Annual Total	5,482	6,881	7,697	7,934	8,805	10,426	11,290	11,534	12,013	
% Change from Previous Year		+25.5%	+11.9%	+3.1%	+11.0%	+18.4%	+8.3%	+2.2%	+4.2%	

Payments include funds from Federal, State, and Local Sources. Income Maintenance Programs are: Aid to Families with Dependent Children, General Assistance, and Emergency Assistance.

Source: Public Assistance Statistics, Department of Health, Education and Welfare.

TABLE 3A

EMPLOYMENT AND TRAINING EXPENDITURES
($ Millions)

	FY70	FY71	FY72	FY73	FY74
MDTA					
Institutional	287	275	356	304	308
JOP - OJT	50	60	69	77	91
Neighborhood Youth Corps					
In School	59	58	75	64	89
Out of School	98	115	122	107	114
Summer	199	253	320	246	459
Operation Mainstream	51	72	85	81	115
Public Service Careers	89	92	58	31	28
Concentrated Employment Program	188	167	155	130	146
JOBS (Federally financed)	149	169	118	73	64
Work Incentive Program	79	64	175	209	250
Job Corps	170	160	202	193	150
Public Employment Program	-	-	962	1,239	
CETA Transition					
PEP-Title II					44
PEP-Title IIA					237
Migrants Program					39
Older Workers					10
SUBTOTAL	1,419	1,485	2,697	2,754	2,144
College Work Study*	152	200	237	270	270
TOTAL	1,571	1,685	2,934	3,024	2,414

*College Work Study funds are actually dollar appropriations, rather than expenditures. Actual expenditures have ranged from 0 to 40 Million Dollars less than appropriations, but data on expenditures are only available to 1974.

TABLE 3B

EMPLOYMENT AND TRAINING EXPENDITURES

($ Millions)

	FY75	FY76	TQ[1]	FY77	FY78
CETA					
Title I	1,585	1,528	395	1,871	1,910
Title II	669	666	98	-a	-a
Title III					
Total	229	232	67	254	
Excluding Youth					684
Summer					755
Title IV (Job Corps)	210	134	45	210	376
Title VI	872	1,624	997	2,701[a]	4,824[a]
Transition	10				
Summer Youth	391	588	23	595	_2
Youth Employment and Training Programs					984
Work Incentive Program	130	230	56	245	250
Older Americans Act	12	85	-	150	201
SUBTOTAL	4,108	5,087	1,681	6,026	9,884
College Work Study*	420	390	-	390	435
TOTAL	4,528	5,477	1,681	6,416	10,419

1. TQ represents the period from July 1 to September 30, 1976, the Transition Quarter resulting from the government's change from a July 1 Fiscal Year to an October 1 Fiscal Year.

2. The Summer Youth Program is now reported as CETA-Title III-Summer.

*College Work Study funds are actually dollar appropriations, rather than expenditures. Actual expenditures have ranged from 0 to 40 Million Dollars less than appropriations, but data on expenditures are only available to 1974.

[a]Expenditure data for Titles II and VI are combined and reported under Title VI for Fiscal Years 1977 and 1978.

Data Source: Various Employment and Training Reports of the President.

same basis of comparison as with the programs already discussed, we can say that for the three pre-recession years, 1971-73, employment and training expenditures were $8.0 billion, and for the next three years, 1974-76, the total was $14.5 billion. This was an increase of a little more than 80 percent.

The largest increases in employment and training expenditures came long after the recession had ended. As Table 3B shows, expenditures increased to $5.5 billion in FY 1976, and to $6.4 billion and then $10.4 billion in succeeding years. These increases were responsive to continued high levels of unemployment despite the end of the recession, and to the inauguration of a new administration with different priorities from the outgoing administration.

Chart 4 shows relative changes in expenditures in the three major categories of programs, as the unemployment rate changed. Expenditures in each category (unemployment insurance, income maintenance, and employment and training) are shown simply as percentages of their first quarter 1970 level. By 1978, employment and training showed the largest relative increase, but most of that increase came after the peak of the unemployment rate in 1975. Income maintenance expenditures show a relatively slow but steady increase over the period, with a modest response to changes in the unemployment rate. Unemployment insurance shows the greatest fluctuations and the closest relationship to changes in the unemployment rate, peaking at the trough of the recession and then automatically receding.

What is critical in this comparison is that unemployment insurance expenditures did not rise by nearly as much in the 1970 recession as in the 1973-75 recession; and by late 1978, three years after the beginning of the recovery, they were still substantially higher than they had been at the worst of the 1970 recession. The explanation is reasonably obvious: The unemployment rate in late 1978, after three years of recovery, was still higher than the peak rate of the 1970 recession.

A Critique of the 1973-75 Experience

Some of the powerful advantages of unemployment insurance as an employment policy instrument during recessions are obvious from the foregoing analysis.

1. The system is in place and in a state of readiness. When a recession begins, there is no need to wait for new legislation and new appropriations.
2. Expansion and contraction are automatic and rapid as the economy moves from prosperity to recession to recovery.
3. The system is self-financed, primarily by an employer payroll tax, with provisions for changes in tax rates in case of need.

These advantages are the reason for characterizing the unemployment insurance system as a great national asset. To an extent that is not generally understood, it is one of the most important "automatic stabilizers" developed during the Great Depression of the 1930s as a safeguard against a

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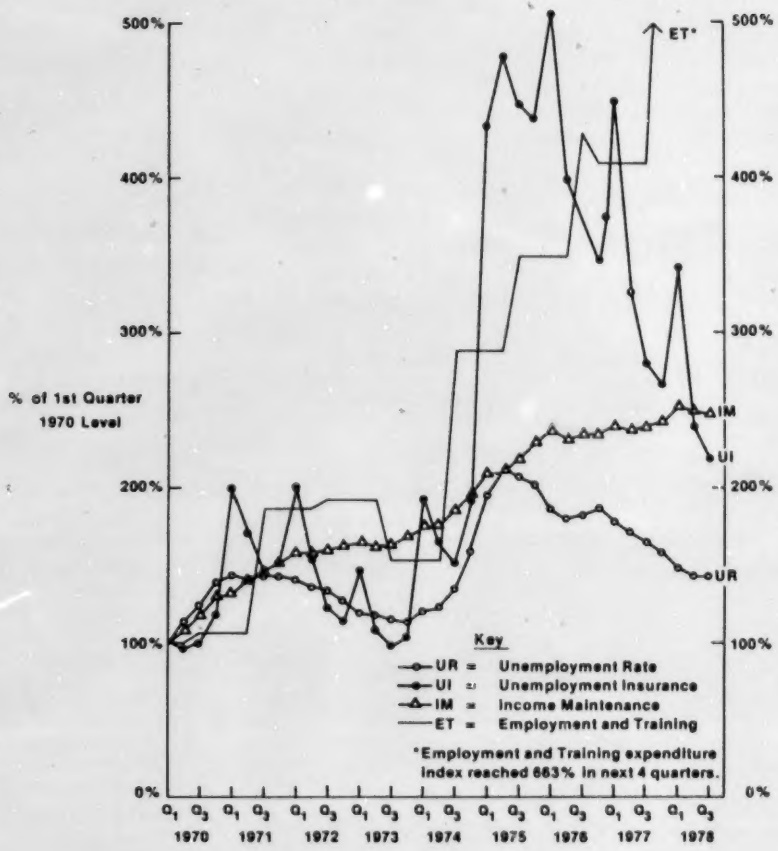
CHART 4

Expenditures & Unemployment as % of 1st Quarter 1970 Level



recurrence of that catastrophic economic collapse. These considerations make it all the more important to avoid serious damage to this system by overloading it with burdens in excess of those it was designed to carry. This point will be discussed further below.

For all of its strengths, unemployment insurance also has some important disadvantages.

1. Benefits are not directly tied to needs. Some of the unemployed who collect benefits have sufficient assets to tide them over a short period of unemployment; others find the benefits insufficient to meet even their basic needs, and many claimants exhaust their eligibility in a recession period before they find new jobs; and new entrants to the labor market are not eligible for regular benefits.
2. The largest benefits, generally speaking, go to those who had the highest earnings and steadiest employment records before they became unemployed.
3. Because financing is basically on a state-by-state basis, a recession throws the heaviest burdens of unemployment insurance on the states that are least able to afford them--i.e., those with the highest levels and longest durations of unemployment.

The 1973-75 recession seriously weakened the financial strength of the unemployment insurance system, and the persistence of high unemployment levels after general economic recovery began made it very difficult for a number of states to restore the financial strength of their separate systems. There is a plethora of statistics to document this general statement. Perhaps the simplest way to support the point is to say that by the end of 1976, 22 states (or jurisdictions) had completely exhausted their reserve funds and were unable to meet their current benefit payments from current revenue. In the common understanding of the term, these 22 systems were bankrupt.

There is, however, a safety net provided for such contingencies. The safety net is a loan fund, controlled by the federal government and financed out of the federal share of the payroll taxes. States may borrow from this fund, interest-free, with long repayment terms. But if a state is unable to start repayment on time, then (under certain circumstances) the federal government is authorized by existing law to collect the debt by, in effect, raising the payroll taxes on all employers in the delinquent state. (States which are delinquent but which can show that arrangements have been made to pay off their debts in a reasonable time can avoid this outcome; but this too usually involves an increase in payroll taxes). Thus, in November 1979 (when certain determinations had to be made by the Secretary of Labor), two states were outstanding by reason of their indebtedness: Michigan and Pennsylvania. They owed $624 million and $1.2 billion respectively. Their difficulties were at least partly attributable to the fact that by then they were among the states that had already been hit by the heaviest layoffs in the nation. All of the states that had borrowed during the 1973-75 recession and still had not repaid their borrowings owed a total of $4.5 billion when the time for decisions by the Secretary of Labor arrived. (See Table 4). Most of the states were able

TABLE 4

OUTSTANDING FEDERAL LOANS TO STATE RESERVE FUNDS, BALANCE

(Millions of dollars)

	1972	1973	1974	1975	1976	11/29/79
Alabama				10.0	30.0	
Arkansas					20.0	
Connecticut	31.8	53.5	62.0	252.2	363.2	371
Delaware				6.5	20.5	47
Dist. of Columbia				7.0	33.6	71
(Florida)*					(10.0)	
Hawaii					22.5	
Illinois				68.8	515.3	946
Maine				2.4	14.9	36
Maryland					36.1	
Massachusetts				140.0	265.0	232
Michigan				326.0	571.0	624
Minnesota				47.0	123.0	
Montana					1.4	7
Nevada					7.6	
New Jersey				352.2	497.2	652
New York						
Oregon					18.5	
Pennsylvania				173.8	552.9	1222
Puerto Rico				35.0	57.0	89
Rhode Island				45.8	65.8	103
Vermont			5.3	28.3	37.5	35
Washington		40.7	44.1	94.1	149.4	
Virgin Islands						10
United States	31.8	94.2	111.4	1,589.1	3,402.4	4,445

*Florida repaid before end of year; Ohio also borrowed sums in the 1977-79 period which had been repaid by 10/14/79.

Total loans extended in excess of $5.36 Billion.

to avoid mandatory adjustments in payroll taxes (retroactive to January 1979) by making satisfactory showings of repayment arrangements. Michigan avoided the adjustment by repaying its entire debt, while simultaneously announcing that it would need to start borrowing substantial sums again early in 1980 because its benefit payments were exceeding current revenues. Pennsylvania did not do either, was adjudged delinquent, and payroll taxes were adjusted accordingly.*

One of the standard measures of the financial strength of the unemployment insurance system is a set of numbers known as "reserve multiples." These numbers, broadly speaking, relate the relative size of the state's reserve funds to the relative size of the highest 12-month benefit payout in past experience (for a more complete explanation, see Appendix B). Changes in the reserve multiples from 1973 to present are an important measure of the changing financial strength of the unemployment insurance system.

Chart 5 represents the aggregate changes in graphic form. The chart is constructed so that a shift of the line for a particular year to the left shows a decrease in reserve multiples, and vise versa. The steady general deterioration from 1973 to 1976 is quite apparent. So is the fact that the reserve multiples at the end of 1979 ("Current" on the chart) are generally much lower than in 1973, just before the onset of the last recession. Obviously, by this important measure, the unemployment insurance system is presently much weaker than it was in 1973. If the recession now under way approaches the severity of the last recession in its effects on unemployment, a majority of the state unemployment insurance reserve funds will be exhausted. Many, perhaps most, states will lack the funds to pay current benefits from current revenues, and will have no reserves of their own from which to make up the difference.

Loans from the federally-controlled loan fund will provide a temporary solution for this problem, if it should develop. However, it seems inevitable that the provisions now existing in federal statutes for compelling the repayment of these loans will create increasingly severe problems. In particular, employers in those states which are most afflicted by unemployment will have their payroll taxes raised--often significantly above the tax levels in competing states--in order to pay off the loans. The states with current and prospective above-average unemployment rates are among those most affected by the recent wave of permanent plant closings. Public policy should be designed to encourage new enterprises to move into these states to absorb the permanently displaced workers. Raising UI tax rates in these hard-hit states substantially above those in more fortunate states tends to operate in the opposite direction.

One obvious way to relieve this problem would be to provide for federal grants, instead of loans, when a state system exhausts its reserves and cannot pay current benefits from current revenues. Proposals along these lines are currently under discussion. One proposal would finance the

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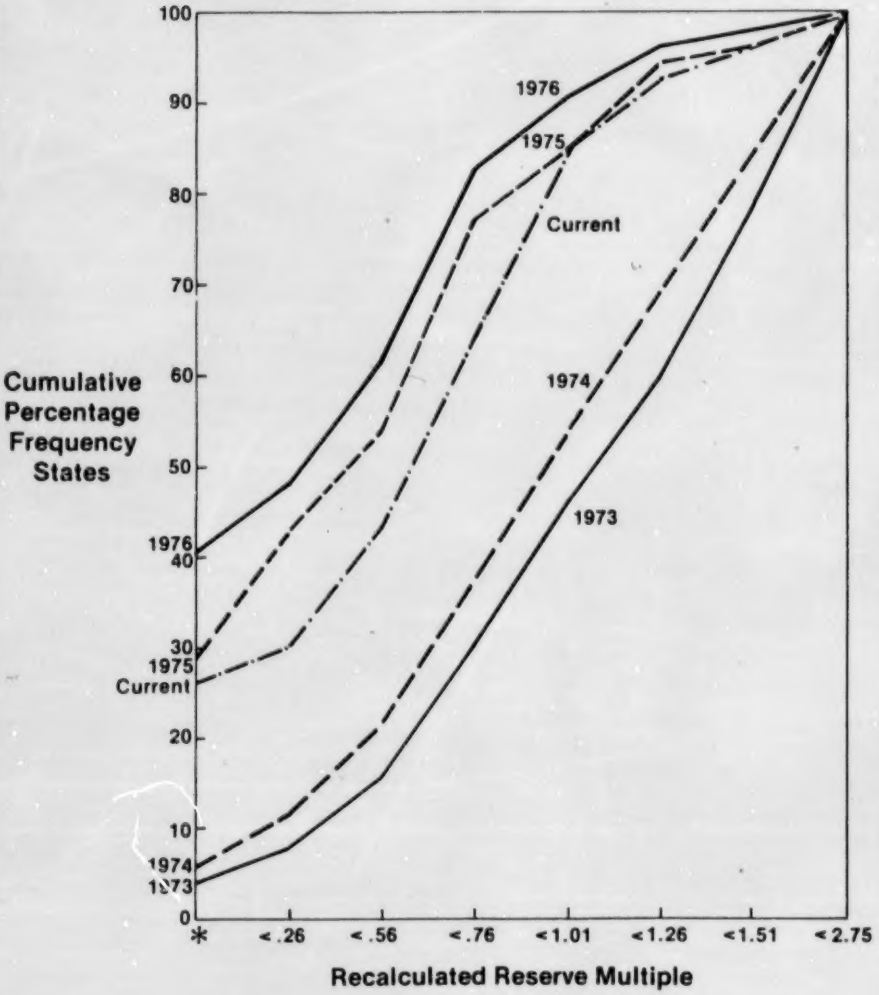
*During the first four months of 1980, Michigan borrowed $280 million; Pennsylvania, another $222 million; and Rhode Island, $16 million.

Cumulative Percentage Frequency Distribution of States' Recalculated Reserve Multiples 1973 - 1976 and Current



grants by means of a permanent, uniform increase in the federal portion of the payroll tax by 0.1 percent. Superficially, this appears to be a simple and adequate way of dealing with the problem of exhausted state UI reserves. But as stated it ignores some of the complex realities of federal-state relationships in this system. The states retain fairly broad discretion over tax rates, benefit levels, eligibility requirements and other important variables. There is considerable variation among the states. If federal grants became available automatically to any state that ran out of money to pay benefits, there would be at least a temptation for the states to keep tax rates low and benefits high. This temptation could be eliminated by federal prescription of minimum tax rates and maximum benefit levels as a condition of federal grants. Many--perhaps most--states would resist such federal standards as an invasion of the independence of the state systems. Thus the stage would be set for what might become a protracted political struggle, with an uncertain outcome.

A National Commission on Unemployment Compensation has been studying the entire program and is scheduled to deliver a report with recommendations on June 30, 1980. Consideration of this report and its recommendations may be expected to extend over a substantial period of time, perhaps years. It may provide the basis for long-run restructuring of the finances of the UC program. It probably cannot escape the basic dilemma of UC financing. If the states remain responsible for paying for all of the regular benefits that are claimed within their borders, with loans from a federal fund when needed, then (sooner or later) the employers in the states with the highest unemployment rates will be required to pay higher payroll taxes than the employers in states with lower unemployment. If some kind of "equalizing," non-repayable federal grant is made available to states in times of heavy unemployment, the price of the grants may be a substantial extension of federal control over the payroll tax rates and benefit levels in the states receiving such grants.

The fundamental alternative to a basic restructuring of UC finances is to divert as much of the burden of recession unemployment as possible from the regular UC system. One relatively small step in this direction would be for the federal government to pay the entire cost of the Extended Benefits program, instead of requiring the states to pay half of the cost.* If this arrangement had been in effect during the 1970s, it would have saved the states $3.3 billion, and more than half of the savings would have gone to the states that were forced to borrow from the federal loan fund. Hence, part of the pressure on state funds would have been eased. The additional federal cost could be covered either by a small, uniform increase in the federal share of the payroll tax on all employers in the nation or by appropriations from general revenues.

A more basic question of social policy is, how many billions of dollars should the nation devote to maintaining the incomes of those who are involuntarily idle because of a recession? This is a question which apparently has received little conscious attention. When regular unemployment benefits have been exhausted by large numbers of jobless people,

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*As shown in Appendix A, other temporary extensions of benefits were paid for entirely from federal funds.

supplemental extensions have been enacted with little consideration of possible alternative uses of the funds thus committed. Traditionally, unemployment benefits have been the "first line" of defense against recession-induced joblessness. Despite extensions, some persons exhaust their eligibility for such benefits and reach the last line of defense against income loss, which is one or more of the welfare programs previously discussed. During 1974-76, the nation increased its expenditures for UC benefits and welfare by roughly $30 billion over the level of the three pre-recession years. Some of that increase--perhaps more than half of it--was unavoidable. But surely some part of it could have been used to finance other programs which provide work or training opportunities for the jobless instead of paying them for doing nothing.

Unemployment insurance benefits are most appropriate for workers whose joblessness is relatively short-term, and for those who seem to have a reasonable chance of finding other employment. Welfare payments are most appropriate for those who are unable to work. In between these groups is a middle group composed of workers who can usually find and hold jobs in a tight labor market, but who cannot successfully compete with the millions of better-qualified workers who lose their jobs and enter the job competition when a recession hits. It is this middle group, which is enlarged by a recession, for which federal employment and training programs are most appropriate. When proposals are made, as they undoubtedly will be in the months ahead, for the extension of unemployment insurance payments for periods as long as 65 weeks, we should ask whether this is the best use that can be made of public funds.

As previously noted, rapid expansion of employment and training programs did not occur in the 1970s until recovery from the recession was well under way.* Despite the recovery, unemployment was still high (7.4 percent) when the new administration took office. Within a few months, a large expansion of employment and training programs began, with particular emphasis on the Public Service Employment (PSE) program. Concurrently with this expansion, the level of unemployment insurance payments dropped sharply, and welfare payments leveled off--or, more accurately, increased at a slower rate.

This post-recession experience underscores what may be a fairly obvious point. Employment and training expenditure increases are the most effective--indeed, almost the only available--instrument to relieve excessive and dangerous pressure on the unemployment insurance and income maintenance programs. The direct cost of employment and training programs is higher in the short run than the cost of the support payments provided by unemployment insurance and welfare. Furthermore, it is mainly federal dollars rather than state and local funds that are spent. But in the longer run, the net cost of employment and training programs seems almost certainly to be less than the cost of excessive reliance on unemployment insurance and welfare.

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*The accompanying paper by Vernon M. Briggs, Jr., traces in detail the development of Public Service Employment Programs in the 1970s.

Many words have been written and spoken about the pros and cons of employment and training programs. This is not the place to review all of the contentions. Two basic points have special relevance to this discussion. The overwhelming majority of studies of training programs conclude that, with some exceptions, these programs yield "benefits"--in terms of higher earnings and higher tax payments by participants--that exceed their costs. There is also some as yet tentative evidence that the most disadvantaged participants in employment programs tend to have higher earnings and steadier employment after participation than comparable persons who have not participated in such programs. That is why the net, long-run costs of employment and training programs are much less than the initial outlays for them.

Tax cuts, particularly reductions in the federal income tax, were once generally accepted as the "centerpiece" of employment policy. Tax cuts are still highly favored by some politicians in both political parties as the best and most obvious remedy for unemployment. There is even a new school of thought which prescribes tax cuts as a remedy for inflation. But the evidence in support of federal tax cuts as an effective remedy for unemployment is remarkably weak.

Because of the attention currently being given to tax-cut proposals, it seems worthwhile to illustrate the point just made. The illustration is admittedly simplified for the sake of brevity. Consideration of the complications which will spring to the mind of the informed reader would greatly extend the discussion without greatly modifying the conclusion. Chart 6 compares the job creation effects of a federal income tax cut with a gross cost of $8 billion with the job creation effects of a Public Service Employment program also with a gross cost of $8 billion. The job-creation effects of the tax cut are based on detailed estimates by the Congressional Budget Office.

Two points deserve special emphasis. In the initial transaction, or "first round," the mere transfer of funds from the federal government to taxpayers obviously does not create any jobs at all; only when the taxpayers start spending some of the tax cut is there a job creation effect, and even at that point, there are many "slippages."* Not every dollar spent contributes to the creation of a new job in the economy (some dollars are spent on imported goods, some goods are sold out of inventory, some increased demand is met by lengthening the hours of work of those already employed, and so on). Compare the transactions ensuing from the establishment of the PSE program. In the first round, about 1,000,000 jobs are created; that is the essence of the first-round transaction. Then in the second round the spending of paychecks by the PSE participants is assumed to have the same job creation effects as the spending of tax cut money by taxpayers. The end result is that, dollar for dollar, the PSE program creates about four times as many jobs as the tax cut. It should also be

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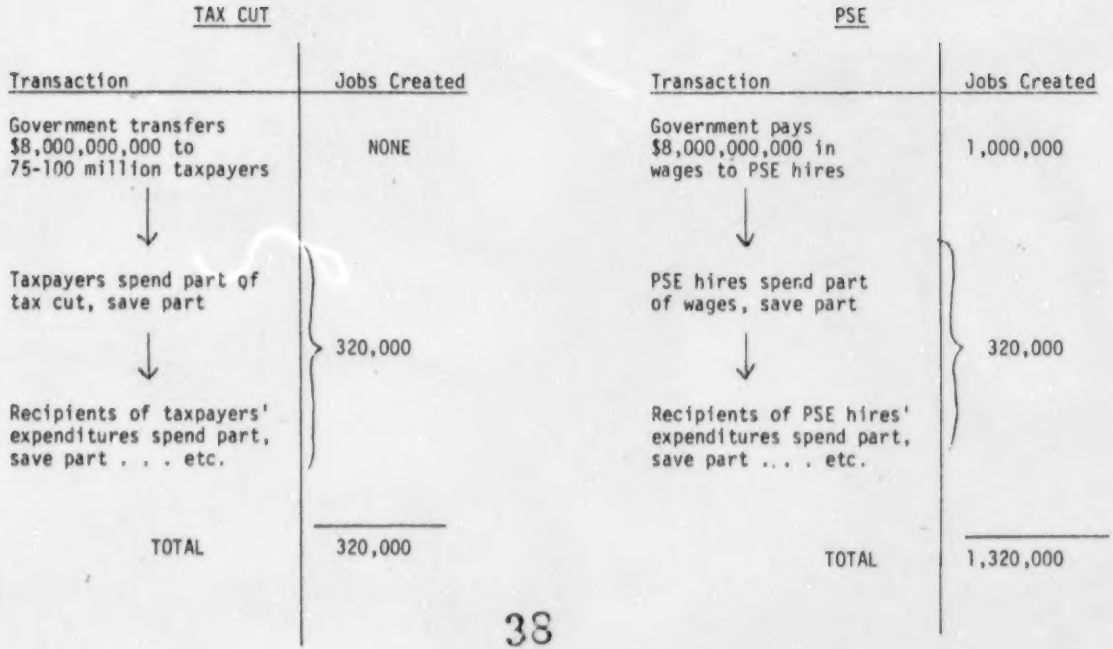
*It should be noted that the "first round" effect of unemployment insurance benefits on employment is also zero. The second round effects are subject to the same "slippages" as those described above.

CHART 6

Comparison of Job Creation by Tax Cut

and by Public Service Employment



observed that the national income is increased by the value of whatever services the PSE participants perform for their salaries. Another difference is that tax cuts go, by and large, to segments of the population that already receive enough income at least to be taxpayers; the PSE jobs, on the other hand, can be and largely have been "targeted" on the long-term unemployed and the welfare recipients who benefit little if at all from tax cuts. Finally, it should be emphasized that the PSE dollars create as many jobs in the private sector as the tax cut dollars do.

We are concerned here with tax cuts as an instrument of employment policy, especially as compared with other available instruments of employment policy. The discussion is not intended to imply that no case can be made on any grounds for tax cuts or for shifts in the burden of taxes.* Nor do we consider the merits of large tax cuts, spread over a number of years, as a remedy for inflation. The basic argument in support of that approach is that the tax cuts would induce such large increases in investment, productivity, output and--ultimately--in employment that inflation would wither away. Whatever may be the likelihood of such an outcome, it obviously has little relevance to the unemployment problems of the recession now beginning, which is the focus of this statement.

Policy Conclusions

1. The nation relied too much on unemployment insurance and other income maintenance programs during the last recession, and too little on employment and training programs, at least during the years of highest unemployment, 1974-76. This excessive reliance left virtually all state unemployment insurance reserve funds in a weakened condition from which they have not fully recovered even now.

2. Because of this weakened condition of most state unemployment insurance reserve funds, equally heavy reliance on unemployment insurance in the current recession (even if it is somewhat less severe than the last one) would probably bankrupt a majority of the state funds. Forced borrowing from the federal loan fund to meet current benefit payments would create grave problems for the near future, and conceivably could compel changes in the basic structure of a valuable and highly useful instrument of employment policy.

3. The extension of unemployment insurance benefits for as long as 65 weeks is an undesirable way to meet the problem of unemployment.

4. Any extension of benefits beyond the period normally provided by state law should be paid for entirely by the federal government, instead of requiring matching funds from strained state reserve balances.

5. The expansion of employment and training programs as recession-caused unemployment increases is the best way to relieve undue pressure on the unemployment insurance system. Unlike employment insurance, the

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*One of the frequently-mentioned possibilities for a "tax cut" in the near future is a cancellation of the Social Security tax increases now scheduled for January 1981. This kind of "tax cut" will not create any jobs, although it might prevent a job loss which might be caused by the tax increase.

employment and training enrollments can be limited to genuine hardship cases. Over the long run, despite higher initial costs, emphasis on employment and training programs might actually cost less than reliance on unemployment insurance and welfare programs to meet the needs of those upon whom the recession imposes substantial hardship.

6. Tax cuts are the least cost-effective instrument for reducing unemployment. There may be adequate justification for tax cuts or the shifting of tax burdens on other grounds; but we now have at hand far more effective instruments than tax cuts to relieve the burdens of unemployment.

APPENDIX A

PROGRAM EXPLANATIONS--UNEMPLOYMENT INSURANCE

UI - Regular state unemployment expenditures. Funds generated from state FUTA tax. Most common maximum--26 weeks.

UCFE - Parallel to UI, for federal employees now unemployed.

UCX - Parallel to UI, for federal servicemen now unemployed.

EB - Federal-State Extended Benefits. For those who had exhausted regular unemployment benefit entitlement. Maximum entitlement to UI and EB not to exceed 39 weeks. Program "triggered on" by high covered unemployment levels, either statewide or nationally; must be approved by state. Costs shared 50-50.

FSB - Federal Supplemental Benefits. Additional benefits to unemployed who had exhausted entitlement to Regular and Extended Benefits. Authorized under PL 93-572, the Emergency Unemployment Compensation Act of 1974. Expired February 1978. Maximum entitlement to UI, EB, and FSB originally not to exceed 52 weeks; later extended to 65 weeks. Funds from Federal government (Expired January 31, 1978).

SUA - Special Unemployment Assistance. Made benefits available to unemployed workers whose previous employment had not been covered under the permanent programs, such as workers in elementary and secondary schools (55 percent), local government administration (8 percent), agricultural workers (7 percent), and other workers in households, services, or nondurable goods manufacturing. Maximum entitlement of 30 weeks. Authorized under PL 93-567, the Emergency Jobs and Unemployment Assistance Act of 1974. Funds from Federal government (Expired June 30, 1978).

APPENDIX B

RESERVE RATIO MULTIPLES

The reserve ratio multiple is a fraction. The numerator is: the current reserves in the state's UC fund as a percentage of total covered wages (on an annual basis). The denominator is: the highest 12-month benefit payout in past experience as a percentage of the total covered wages in that period.

Example: If 1975 was the "worst" year for State X; if it had paid 5 percent of the total covered wages of 1975 in 1975 benefits; and if X now has a reserve fund equal to 5 percent of this year's total covered wages, then the reserve ratio multiple is 1.

In our calculations, the reserve ratio multiples for earlier years (mostly pre-1975) have been adjusted for 29 states by changing the percentage in the denominator to the particular state's worst year prior to 1979, either 1975 or 1976 (29 of 52 jurisdictions had their worst year in history in either 1975 or 1976--most in 1975). The "current" multiple calculation is probably overstated. This places the current multiples for these states on a basis that is properly comparable to earlier (pre-1975) years. In short, we use the same denominator for all years for the particular state. We cannot see any systematic bias or distortion in this approach, but we invite the comments of better-qualified experts.

The numbers per se probably mean less than the direction and magnitude of change over time, especially the recent past. The graph seems to us to provide an illuminating insight into changes in the relative financial strength of the total UC system.

APPENDIX B - TABLE 1

	Historic Reserve Multiple				Recomputed Reserve Multiple				
	1973	1974	1975	1976	1973	1974	1975	1976	9/30/79
Alabama	1.01	.85	*	*	.89	.76	*	*	.41
Alaska	1.12	.82	.71	.69	1.12	.82	.71	.69	.47
Arizona	2.71	2.70	.54	.26	1.27	1.26	.54	.26	.88
Arkansas	1.15	.98	.01	*	.75	.64	.01	*	.24
California	1.02	.67	.38	.38	.98	.84	.38	.38	.94
Colorado	1.62	1.29	.56	.37	1.62	1.29	.56	.37	.83
Connecticut	*	*	*	*	*	*	*	*	*
Delaware	1.43	1.16	*	*	.85	.69	*	*	*
D.C.	1.80	1.01	*	*	.91	.61	*	*	*
Florida	1.69	1.51	.23	.07	1.04	.93	.23	.07	1.04
Georgia	2.64	2.47	1.07	.78	1.97	1.84	1.07	.78	1.05
Hawaii	.70	.44	.10	*	.49	.31	.09	*	.66
Idaho	1.88	1.78	1.43	1.23	1.88	1.78	1.43	1.23	1.26
Illinois	.75	.81	*	*	.68	.74	*	*	*
Indiana	1.55	1.45	.73	.69	1.50	1.40	.73	.69	.93
Iowa	2.28	2.07	.63	.41	1.45	1.32	.63	.41	.80
Kansas	1.79	1.91	1.71	1.59	1.79	1.91	1.71	1.59	1.66
Kentucky	1.22	1.21	.70	.57	1.22	1.21	.70	.57	.55
Louisiana	.89	.93	.81	.83	.89	.93	.81	.83	.69
Maine	.56	.60	*	*	.56	.60	*	*	*
Maryland	.76	.76	.13	*	.76	.76	.13	*	.68
Massachusetts	.63	.42	*	*	.43	.29	*	*	*
Michigan	.57	.38	*	*	.57	.38	*	*	*
Minnesota	.61	.45	*	*	.57	.42	*	*	.59
Mississippi	1.62	1.69	1.14	1.09	1.62	1.69	1.14	1.09	.70
Missouri	1.66	1.60	.38	.32	1.06	1.02	.38	.32	1.59
Montana	.72	.54	.19	*	.72	.54	.19	*	*
Nebraska	2.01	1.77	.56	.70	1.31	1.15	.56	.70	.91
Nevada	.66	.49	.08	*	.66	.49	.08	*	.78
New Hampshire	1.92	1.74	.62	.63	1.40	1.27	.62	.63	.96
New Jersey	.29	.07	*	*	.23	.05	*	*	*
New Mexico	1.60	1.41	.98	.83	1.60	1.41	.98	.83	1.11
New York	1.17	1.07	.41	.14	1.02	.93	.41	.14	.29
North Carolina	2.44	2.49	1.05	.71	1.72	1.76	1.05	.71	.97
North Dakota	1.27	1.24	1.04	.89	1.27	1.24	1.04	.89	.45

*Indicates that state is in debt to the Federal Unemployment Trust Fund.

TABLE 1 (CONT'D)

	Historic Reserve Multiple				Recomputed Reserve Multiple				
	1973	1974	1975	1976	1973	1974	1975	1976	9/30/79
Ohio	1.06	.99	.37	.22	1.06	.99	.37	.22	.45
Oklahoma	.90	.89	.34	.16	.90	.89	.34	.16	1.19
Oregon	.86	.68	.14	*	.86	.68	.14	*	.91
Pennsylvania	.64	.52	*	*	.64	.52	*	*	*
Puerto Rico	.47	.11	*	*	.36	.09	*	*	*
Rhode Island	.52	.21	*	*	.35	.14	*	*	*
South Carolina	3.01	2.83	.56	.41	1.42	1.33	.56	.41	.60
South Dakota	2.75	2.36	1.88	1.29	2.75	2.36	1.88	1.29	.72
Tennesse	1.58	1.59	.89	.72	1.58	1.59	.89	.72	.75
Texas	1.32	1.20	.72	.55	1.32	1.20	.72	.55	.68
Utah	1.85	1.41	.71	.47	1.49	1.14	.71	.47	.72
Vermont	.16	*	*	*	.11	*	*	*	*
Virginia	2.63	2.37	.82	.55	1.95	1.76	.82	.55	.42
Virgin Islands	-	-	-	-	-	-	-	-	*
Washington	*	*	*	*	*	*	*	*	.34
West Virginia	1.20	1.10	.65	.54	1.20	1.10	.65	.54	.25
Wisconsin	1.55	1.47	.44	.54	1.26	1.20	.44	.54	.95
Wyoming	1.46	1.29	1.24	1.23	1.46	1.29	1.24	1.23	1.31

APPENDIX B - TABLE 2

FREQUENCY DISTRIBUTION OF RECOMPUTED RESERVE MULTIPLE

Recomputed Reserve Multiple	1973	1974	1975	1976	9/30/79	1973	1974	1975	1976	9/30/79
*	2	3	15	21	14	3.8%	5.8%	28.8%	40.4%	26.4%
.01-.25	2	3	7	4	2	3.8%	5.8%	13.5%	7.7%	3.8%
.26-.50	4	5	6	7	7	7.7%	9.6%	11.5%	13.5%	13.2%
.51-.75	8	8	12	11	11	15.4%	15.4%	23.1%	21.2%	20.8%
.76-1.00	8	9	4	4	11	15.4%	17.3%	7.7%	7.7%	20.8%
1.01-1.25	7	8	5	3	4	13.5%	15.4%	9.6%	5.8%	7.5%
1.26-1.50	10	8	1	1	2	19.2%	15.4%	1.9%	1.9%	3.8%
>1.50	11	8	2	1	2	21.2%	15.4%	3.8%	1.9%	3.8%
						100.0%				

CUMULATIVE FREQUENCY DISTRIBUTION
OF RECOMPUTED RESERVE MULTIPLE

*	2	3	15	21	14	3.8%	5.8%	28.8%	40.4%	26.4%
Less than .26	4	6	22	25	16	7.7%	11.5%	42.3%	48.1%	30.2%
.51	8	11	28	32	23	15.4%	21.2%	53.8%	61.5%	43.4%
.76	16	19	40	43	34	30.8%	36.5%	76.9%	82.7%	64.2%
1.01	24	28	44	47	45	46.2%	53.8%	84.6%	90.4%	84.9%
1.26	31	36	49	50	49	59.6%	69.2%	94.2%	96.2%	92.5%
1.50	41	44	[illegible]	51	51	78.8%	84.6%	96.2%	98.1%	96.2%
2.75	52	52	52	52	53	100.0%	100.0%	100.0%	100.0%	100.0%

GETTING AT FUNDAMENTALS IN THE FY 81 BUDGET

by Garth L. Mangum*

The most virulent inflation in 60 years slows temporarily only because unemployment rises more rapidly than it has at any time for 40 years. And the slowing is only to an inflation pace never reached in any of our last three wars, while unemployment shoots upward from a low point considered a recession level less than 20 years ago. Add to that the outlook that unemployment will rise to a peak above that of the 1974-75 recession without inflation dropping to its 1976 low. Then anti-recession efforts in 1980 will bring unemployment under control in 1981 only to see price rises at the peak of the next cycle outstripping those of 1979.

A gloomy prospect? Yes, but all too likely unless some set of policies are identified which are as unorthodox as the dilemma in which we find ourselves. So what is proposed? Following up on a brutal monetary crunch by the Federal Reserve Board, the Congress and the administration no sooner convince themselves that a balanced federal budget is the key to economic health than the built-in economic stabilizers make budget balance fiscally unlikely while the pressing needs of millions more unemployed make it politically impossible. Orthodox anti-inflation policy says raise taxes, cut public expenditures, and tighten the money supply. Orthodox anti-recession policy would be exactly the opposite. A reexamination of the basic forces underlying the current economic paradox suggests that it may be possible to do some of both with good effect. In fact, a new set of circumstances may even dictate tax increases during a recession, a practice we now ridicule as pre-1932 Neanderthal economics.

Basic Causes

The current economic situation is totally unique in U.S. history. Never before have we experienced serious inflation except during or immediately after a war with its combination of swollen money incomes earned by producing goods and services which are not offered for sale--too much money chasing too few goods. Periods of unemployment have always had their own one basic cause--total expenditures inadequate to purchase all of the goods and services all of those who want to work are capable of producing. The post-1973 situation is very different but no more difficult to understand if we stop assuming familiar causation and accept a new set of realities.

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Inflation

On the inflation front, the disease is a national commitment to take out of the economy more than we are willing to put into it. The immediate symptom is refusal to accept the inevitable decline in our standard of living which must follow dependence for our most basic energy source upon those not equally needful of that which we produce.

We declared a noble war on poverty at a time when it was relatively costless. The economy was running with a considerable degree of slack. Productivity was high. Social welfare expenditures could spark real growth, a part of which could be reallocated to the poor with some part of the gain left over for the rest of us; everybody could be better off. We ran into trouble only when we pursued simultaneously guns, butter, social reform, and a relatively light tax load. We might have had any three but not all four.

But the world changed far more radically after 1973. The prices of oil from foreign sources jumped literally overnight by fourfold and then pushed persistently upward to twelvefold. In U.S. terms, that meant that every barrel of oil imported must be paid for by trading for it at first four times and now (considering higher prices for our goods) six times as much of the goods and services we might otherwise use for ourselves. Adjusting for the added dollar value we now place on our own labor, the average American now works about six hours to buy the oil from abroad which he received only eight years ago for one hour of labor. All of these are hours no longer available to earn the other components of our standard of living.

We have limited options: (a) we could buy less foreign oil; (b) we could produce more to trade by more of us working longer, harder, and more productively; (c) we could accept a lower standard of living and set out to share it equitably; (d) we could for a short time mortgage our future by cutting our savings rate and increasing our credit purchases to maintain our accustomed standard of living; and (e) we could each scramble competitively for a larger share of the available less, hoping to unload the burden on someone else.

The choice we took is obvious in retrospect. We increased, not decreased, our oil imports. We did increase our labor force participation rates with more workers per family struggling to maintain accustomed living standards. We cut our savings rates to spend on consumption what might once have gone to productivity-increasing investment. We went deeper into debt until eventually we had to slow up to repay. We tried to hide our inevitably reduced real income behind a facade of money incomes.

And Unemployment

The demand for labor is a derived demand--derived from the demand for the goods and services labor produces. There is only one way to create jobs: someone must spend money for the purchase of goods and services. Purchasing oil from Arabs does not create jobs in the United States unless those dollars eventually make their way back home to purchase the products

of American labor. But now not only the U.S. but the whole industrial world pours its earnings into nations which do not have either the consumption or the investment capacity to absorb expenditures at that level. During this year the OPEC nations will receive from foreign earnings between $80 billion and $120 billion more than they will be able to spend, no matter how profligate they may be.

What is the classic way to slow economic growth? Raise taxes without increasing public expenditures, absorbing potential purchasing power by generating a budget surplus. Only now we have given others the power to impose that tax upon us, regardless of our domestic needs, and to garner the surplus to themselves.

And Both

This is not necessarily to fault the OPEC nations. Many of them are doing themselves irretrievable damage, in part in response to political pressures from the industrial world. They are draining out of the ground an irreplaceable resource in return for idle coinage they cannot use, employing in the process foreign workers who will leave nothing permanent behind.

Meanwhile, we had learned we could not have guns, butter, social reform, and light taxes. We have yet to learn that we cannot have oil, butter, social reform, and light taxes. We have learned that deficit financing could spark economic growth and buy costless progress when there existed idle resources and the potential for both producitivity and production. An economy which has allowed its productivity to run down by failing to reinvest in it, has raised its labor force participation rates as fast as we have, has failed to keep up with the problems of structured unemployment, and has been laggard in adjusting its unemployment indicators to measure the real slack in the economy has few real resources to be ignited by the spark of deficit funding.

What To Do?

Any real solution must deal with real causes:

1. Reduce dependence on foreign energy sources.
2. Restrain total expenditures to rise no more rapidly than the increase in real output.
3. Increase productivity as well as production.
4. Equitably share the inevitably reduced standard of living.

Reduced Energy Dependence

To use up someone else's scarce resources and save one's own would be wise policy in some circumstances, if one did not become addicted, dependent, and subject to blackmail. But ours is an addiction succumbed to

in the absence of policy. There is no methadone for painless withdrawal. There are two simple ways to cut off the flow: (1) impose an import quota, either "cold turkey" or in gradual increments; (2) impose an import tax, which at current apparent elasticities in the demand for petroleum products would need to be high enough to raise gasoline prices by about 50 cents per gallon. Again, that could be done in one increment or several. The result would be a one-time increase in the average price level, but there is no long-term solution to energy dependence until the domestic price rises to at least equal replacement costs for domestically produced energy. The resultant drop in U.S. demand for foreign oil would aid other industrial nations and, in the long run, even OPEC nations by loosening their stronghold on the world's energy jugular. Favored treatment for Western Hemisphere oil in import quotas or taxes could promote a less vulnerable lifeline as well as good neighbors.

The gains will not be fully realized unless domestic energy markets are then allowed to seek their own levels. The traditional "it's the poor who pay" imposition of burdens can be avoided by compensating income redistributions. A substantial rise in energy prices would permeate the whole price level. However, immediate action so that energy prices rose early rather than late in the recession cycle while other prices were easing would minimize the impact. And keeping the added public and private revenues within the U.S. spending stream would have an entirly different effect than rewarding OPEC time after time.

Restraining Total Expenditures

There was wisdom in the once liberal and now conservative adage to balance the federal budget over the business cycle without allowing a persistent growth in public debt. But even that is a too narrow construction. The federal budget is only a portion of the total government sector. Until the onset of the current recession, the federal deficit was offset by a surplus in state and local government budgets, in part because much of the federal expenditure is in the form of grants and aid to states and localities. However, governments are not unique generators of inflation, though they do sanction it by their monetary policies. It is when the total of all expenditures by consumers, investors, and governments grows at a pace which exceeds the flows of output of goods and services that inflation becomes inevitable.

The appropriate policy over the months and years ahead is to balance those total flows through a combination of fiscal and monetary policies. That may or may not imply a precise federal budget balance at particular points in time. It will mean a more restrictive combination of fiscal and monetary policies than traditional in a deepening recession. In the downswing of a recession when slack is increasing in the utilization rates of labor, capital and raw materials, enlarged deficits and easier money do not accelerate inflation. The automatic stabilizers such as unemployment compensation have the advantage that they follow immediately upon the rise of unemployment and phase out as it declines. Discretionary policy decisions are too slow in coming, however, and tend to expand expenditures on the upswing of the cycle just when they should begin phasing out. Title III of the Comprehensive Employment and Training Act

has a trigger expanding public service employment after three successive quarters of high unemployment. The funds supposedly become available after nine months, therefore, but with delays in implementation, expansion on the upswing is almost asured. Yet if the go/stop, unemployment/inflation cycle is to be dampened, aid for the unemployed must come on earlier and retract sooner. An anomaly of the current situation is that creating unemplomentthrough tight monetary and fiscal policies will do little to restrain inflation. Yet once into unemployment the way out may accelerate inflation if not carefully balanced.

Productivity Investments

The courses of the extraordinarily slow productivity increases of the past decade are too complex for treatment here, but one of them is clearly the low rate of investment which has prevailed over that period. That in turn had a number of causative factors--federal competition for loanable funds, alternative investments in environmental safeguards, and preference for consumption over saving. There are also many prospective solutions, but an investment favoring tax policy is certainly among them. That long-term need is a strong argument against consumption-favoring anti-recession tax cuts.

Sharing the Burden

All of that boils down to the necessity of facing up to the fact that the real standard of living of the United States has fallen and can rise only at the pace at which the labor force size increases (after reducing excessive unemployment) and output per person rises. But if we do nothing to effect the patterns in which that reduced real national income is distributed, the costs will inevitably be visited upon those who are most vulnerable--those who are currently dependent upon social welfare programs, those most vulnerable to layoffs, those new entrants to the labor market who have the hardest times breaking in, and those employed at already poverty wages who will fall further behind. The most direct way to protect those in such marginal status without exacerbating inflation is to provide them with incomes and employment paid for by taxes upon those whose employment and incomes are adequate and uninterrupted. On the current scene, that means reducing the temptation to cut taxes (except for productivity generating purposes) but under extreme circumstances might even involve raising taxes during a recession.

Unemployment insurance is one device by which the employed guarantee the incomes of the unemployed. However, our unemployment insurance system is already in trouble. The UI trust funds of several major industrial states had not recovered from the 1974-75 recession before the 1980 recession struck them. There will have to be basic reforms before that system can bear any greater burdens.

Public service employment, supported conceptually by equal imposition of taxation upon the working population, is another useful device. Subsidized private employment in investment creating activities such as tax supported public works is another desirable approach.

But the first step is to abandon the conventional wisdom that taxes must be cut and cannot be allowed to rise during a recession. As long as total expenditures rise at a pace equal to the growth in output there will be no inflation. Those upon whom new taxes are imposed (or for whom old taxes would otherwise be cut) will be burdened, but they will only be sharing the burdens normally vested upon their less fortunate fellow citizens. And in the long run, the dampening and eventual amelioration of the inflation cycle will improve the status of all. Tax cuts in current circumstances should have to justify themselves by their productivity generating potential. Direct expenditures to create incomes and employment for anti-inflation policy victims is a more appropriate recourse for 1981.